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PROGRAMME OF WORK OF THE INTERGOVERNMENTAL WORKING GROUP OF EXPERTS ON INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING: DISCUSSION OF ACCOUNTING AND REPORTING ISSUES IDENTIFIED DURING THE EIGHTH SESSION

Organization of the accounting profession and the role and qualification of auditors

Report of the Secretary-General

SUMMARY

The report is intended to provide background information to those countries that are in the process of establishing the accounting profession and to present issues that should be taken into consideration. A general overview of the structure and organization of the accounting profession is given in section I. It covers the objectives of the accounting profession, the administrative issues that should be considered in setting up a professional accountancy organization, the responsibilities of the profession in the education and training of its members and potential members, the establishment of a code of conduct, both for the protection of the public and for the profession's reputation, the measures that should be in place to ensure that there is adherence to the code, and services that should be considered for the benefit of members. It is recognized that the extent to which these matters will be of relevance for a particular professional accountancy

* E/C.10/AC.3/1991/1.

organization will depend on its principal objectives and the size of its membership. Section II covers the role and qualification of auditors. Since auditors form a significant part of the accounting profession in most countries, this section focuses on auditors, briefly covering, in general terms, what constitutes an audit; it then reviews the qualities that are required in an auditor, the overseeing of auditors and the role of auditing standards.

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INTRODUCTION

1. At its eighth session, in March 1990, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting decided that it would be worthwhile to hold an exchange of views at its ninth session, in March 1991, on the organization of the accounting profession and on the role and qualification of auditors. Although the subject is not directly related to financial accounting and reporting standards, it was considered that such a discussion would be of benefit to those countries that are in the process of establishing the accounting profession, for example, several countries in Africa and in Eastern Europe, and to present issues that should be taken into consideration by countries that currently do not have any established professional accounting organizations.

2. The objective of this report is to provide some background that will assist Working Group members in the discussion. It is not intended to be a comprehensive paper on the subject. Since circumstances, cultures and needs vary from country to country, it cannot cover all the issues that are pertinent to a particular country. In preparing the report, reference was made to material produced by international groups. Such material included the Eighth Directive of the Council of the European Communities, documents prepared for a round-table discussion on the qualification of auditors, which was held in May 1987 under the sponsorship of the Working Group on Accounting Standards of the Organisation for Economic Co-operation and Development (OECD), including submissions from most of the European and other OECD countries represented on that Group, Education Guidelines and Ethical Standards issued by the International Federation of Accountants (IFAC) and Auditing Guidelines issued by its International Auditing Practices Committee (IAPC), responses to a survey questionnaire drawn up for this discussion from Brazil, China, Cyprus, Czechoslovakia, Hungary, India, Mexico, Spain, Switzerland, Turkey, Uganda and the United Kingdom of Great Britain and Northern Ireland, pronouncements of the Canadian Institute of Chartered Accountants (CICA) and the Institute of Chartered Accountants of Ontario (as being representative of the accounting profession in North America), and selected relevant literature on the subject.

SUMMARY OF CONCLUSIONS

A. Organization of the accounting profession

3. A professional accountancy organization should clearly state its objectives for the benefit of both its members and potential members and the communities its members service.

4. The objectives of the accounting profession may be summarized as follows:

(a) To ensure that the public is protected through the observance by members of the accounting profession of the highest standards of professional and ethical conduct;

(b) To obtain public recognition of the broad range of skilled services provided by its members;

(c) To protect members' interests.

5. The objectives of specific professional accounting organizations should be tailored to their specific goals and needs.

6. A professional accountancy organization should be structured to enable it to meet its objectives in an efficient and effective manner.

B. Qualification of auditors

7. An individual must be sufficiently educated and adequately trained before being certified to act as an auditor.

8. An auditor must be independent of the management of the entity being audited, and must approach an audit assignment with due care and with an objective state of mind.

9. It is the responsibility of the professional accountancy organization of which an auditor is a member, or other body by which an auditor is certified, to ensure that the necessary educational and ethical standards are in place, and that they continue to be met.

I. ORGANIZATION OF THE ACCOUNTING PROFESSION

A. Nature of the accounting profession

10. The organization of the accounting profession first dates back to January 1853, when eight accountants in Edinburgh, Scotland, met for the primary purpose of seeking recognition of their occupation as a separate and distinct profession. Their deliberations resulted in the formal constitution of the Institute of Chartered Accountants of Edinburgh. Since that time, numerous professional accountancy organizations have been established throughout the world. The process is ongoing, with the present formation of such organizations in several European countries, and consideration being given thereto in several countries on the African continent.

11. In 1977, the International Federation of Accountants (IFAC) was established. Its initial membership was 63 organizations representing 49 countries, but within a decade, membership had grown to 105 organizations from 79 countries. The establishment of IFAC recognizes the need for international co-ordination of the objectives of professional accountancy organizations, and the means to achieve those objectives. Accounting is an international profession, and with the increasing evolvement of crossborder activities, it is important that there be a high degree of equivalence in the professional standards and qualifications for membership of the accounting profession. The broad objective of IFAC is to develop and enhance a co-ordinated world-wide accounting profession with harmonized standards.

12. The term "profession" is defined as follows:

> "A vocation in which a professed knowledge of some department of learning is used in its application to the affairs of others, or in the practice of an art founded upon it." 1/

13. The term "accountancy" is defined in broad terms as "the theory and practice of accounting: its responsibilities, standards, conventions, and activities". 2/

14. The size of accountancy organizations varies considerably from organization to organization. For example, the Institute of Chartered Accountants in England and Wales has over 87,000 members, and the Institute of Chartered Accountants of India, approximately 60,000 members. On the other hand, the Institute of Certified Public Accountants of Cyprus has only 423 members, and the Camâra dos Revisores Oficiais de Contas in Portugal has 460 members. Also, whereas many organizations comprise accountants working in commerce and industry, government and other disciplines, as well as in public practice (auditing), others consist solely of members in public practice.

B. Objectives

15. The stated objectives of any organization depend, to a large extent, on what that organization aims to achieve. Within the accounting profession throughout the world, there appears to be a common thrust in this area, at least with regard to broad objectives. The following is a sample of such stated objectives:

(a) To seek public recognition of the broad range of skilled services that qualified accountants can provide;

(b) To protect the public by ensuring the observance by its members of the highest standards of professional and ethical conduct;

(c) To promote and increase the knowledge, skill and proficiency of members of the organization and students;

(d) To regulate the accounting profession;

(e) To promote and protect the welfare and interest of the organization and the accounting profession;

(f) To maintain the legitimate rights of its members;

(g) To preserve at all times the professional independence of accountants in whatever capacities they may be serving;

(h) To advance the theory and practice of accountancy in all its aspects;

(i) To ensure that members obtain the necessary back-up support that enables them to meet the needs of the community in areas in which they have special knowledge and expertise.

16. Some of the more specific objectives noted were as follows:

(a) To draft the regulations and rules for the profession and report to the appropriate regulatory authority for approval;

(b) To carry out responsibilities delegated by various regulatory bodies, such as examinations and registrations of accountants and accounting firms;

(c) To provide professional solidarity among members and prevent unfair competition among them.

17. In some professional accountancy organizations, the resolution of disputes or disagreements among members appears to be an objective. This was not found to be a commonly stated objective, however.

C. Setting up a professional accountancy organization

18. Many professional accountancy organizations have legislative backing. Others are voluntary associations and tend to be somewhat less formal. Professional accountancy organizations are normally controlled by their members and not by Governments or other regulatory bodies.

19. Any legislation under which a professional accountancy organization is constituted normally gives it the authorization and power necessary to enable it to undertake what is required if it is to accomplish its objectives. It is usually left up to the organization itself, through its elected or designated representatives, to work out the detailed procedures, however.

20. It is highly desirable for a professional accountancy organization to clearly set out how it intends to run its affairs, both for the benefit of its members and for other parties with which it is likely to be associated. The Canadian Institute of Chartered Accountants, for example, states that its purpose is to promote by lawful means the practice of accountancy within Canada, and, in carrying out this purpose, it has all the powers necessary:

(a) To administer and manage its affairs and business;

(b) To develop appropriate standards of qualification for admission to membership;

(c) To maintain appropriate standards of professional conduct for all its members;

(d) To establish and improve standards of financial accounting, reporting and auditing;

(e) To establish categories of membership;

(f) To determine rights, privileges, terms and conditions applicable to those categories, and to fix the fees, dues and levies in respect of those categories;

(g) To grant certificates and organize and present programmes and courses of post-qualification education for members;

(h) To promote the knowledge, skill and proficiency of members;

(i) To conduct, direct or support studies in accounting, auditing and financial matters;

(j) To promote and co-ordinate strategic planning for the profession, and to encourage its members to adapt to changing conditions;

(k) To communicate with Government, the public, the profession and other interested groups and individuals on national policies, legislation and other matters of concern to both its members and society in general;

(l) To undertake what is necessary to give the public a greater appreciation and understanding of the profession of accounting;

(m) To maintain co-operation and liaison with other national and international professional and business organizations;

(n) To promote international harmonization and co-ordination of accounting and auditing standards;

(o) To promote the practice, profession and common interests of its members;

(p) To deal with any other matters relating to accountancy. 3/

21. The above list sets out the type of matters that would be of relevance to a typical professional accountancy organization. These matters will vary, depending on the objectives of the organization, its specific needs and any responsibilities that have been delegated to it. For example, some professional organizations are involved in setting auditing standards (and even accounting and financial reporting standards), whereas others are not so involved. In some organizations, university degrees and professional qualifications of other organizations are accepted as conditions for membership; such organizations would therefore not get into training and education to the same extent as those that do have such responsibilities.

D. Structure of a professional accountancy organization

22. The structure of a professional accountancy organization will depend on both the size of the organization and its objectives and purpose. Most organizations will have a governing body (often referred to as "Council", "Board of Governors" etc.).

23. Governing bodies are generally concerned with the policy matters of the organization. They will develop (generally, for approval by the organization's members) any by-laws necessary to carry out the objectives of the organization, and approve resolutions on major administrative matters. They will establish the schedule of fees that are to be paid by its members and students, and by others making use of the organization's services. They will appoint, or approve the appointment of, committees (or similar groups) that are set up to undertake a variety of functions (for example, finance, investments, education and training, accounting and auditing standards, government relations, discipline of members). The number of committees appointed will often depend on the size and complexity of the organization. For small organizations, many, if not all, of these functions will be the responsibility of the governing body itself. In larger organizations, not only will several committees be appointed, but sub-committees will also be set up to undertake specific functions. Further, an Executive Committee will often pre-screen many of the issues prior to their presentation to the governing body for its approval.

24. Most organizations will normally have full-time and/or part-time staff to look after the day-to-day matters and to prepare material for consideration by the governing body and its various committees so that those groups can concentrate on policy issues. Again, the size of staff will depend to a major extent on the size of the organization.

E. Professional designation

25. The professional designation is regarded as an important issue in many professional accountancy organizations, because it is an indicator of professional competence and informs the public that the holder of the designation has the required education and skills to perform the service of a professional accountant.

26. The professional designation is so important that it is normally protected by law, and its use is prohibited other than by members of the organization to which the designation relates. Wrongful use normally results in legal action.

27. Many organizations supplement the standard designation with additional designations (such as fellowships) that are indicative of length of professional experience or of outstanding service to the profession. It is becoming less common, however, for such designations to be granted based solely on length of service. With the increasing use of "specialization", designations that are indicative of "specialist" skills are also becoming more common.

F. Qualification for membership

28. To protect both the public interest and the profession's integrity, accountancy organizations will either require applicants for membership to undertake an educational and training programme, and normally pass a series of examinations before they can describe themselves as being professional accountants, or require the applicant to have completed the programme of some other professional

accountancy organization. The latter approach may be adopted for a number of reasons, for example:

(a) The size of the organization may be such that the cost of it establishing its own programme is prohibitive;

(b) The organization is relatively new and has not had time to establish its own programme;

(c) The organization comprises members who already have the necessary educational requirements because of membership in a similar organization.

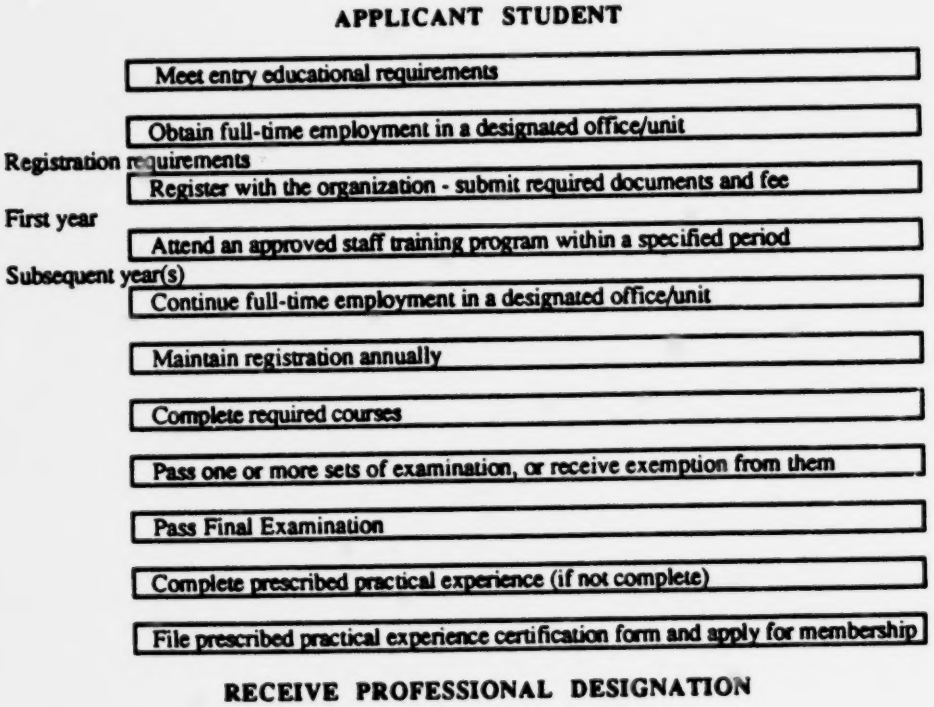
29. In addition, membership of other specified organizations is sometimes accepted as meeting the requirements for membership because of the similarity of the educational and training programme. Owing to crossborder activities, there are several moves being undertaken to try to establish reciprocity of membership between professional accountancy organizations of similar status and stature in different countries. In such situations, it is often a requirement that courses, followed by examination in subjects such as law, taxation and professional standards, be taken to ensure that the applicant is knowledgeable about local conditions.

G. Education and training

30. With the increasing complexity of business, educational and training requirements have tended to become more rigorous. It is not uncommon for it to be a condition that the applicant must have a university degree before the professional organization's own educational and training programme can be commenced. As a minimum, university entrance level, followed by the successful completion of courses in specified subjects, is now normally required. Some organizations also have an admission examination that tests the applicant's education background and intellectual skills. The education programme itself often consists of a prescribed number of courses that have to be completed in specified subjects.

31. The education programme may be supplemented by a programme of practical training, in order to ensure that student accountants are able to apply their academic background and technical skills to the types of problems likely to be encountered on becoming full members of the accounting profession. Because close and expert supervision is usually needed if full advantage is to be obtained from such a training programme, some organizations require that students be trained under the direct supervision of one or more of its members, and/or only in those offices designated as offering a sufficient amount and variety of appropriate experience to prepare them to practise as accountants once they have qualified for membership. Some organizations require that the practical experience training programme be undertaken simultaneously with its educational programme; others permit the educational programme to be completed, and the necessary examinations passed, before the practical experience programme commences.

32. Educational and training programmes are often very detailed. The figure below sets out, in general terms, an example of the stages a student might have to go through before becoming a member of the profession. As is the case with the objectives of the profession, the processes will vary from organization to organization.


APPLICANT STUDENT
Meet entry educational requirements
Obtain full-time employment in a designated office/unit
Registration requirements
Register with the organization - submit required documents and fee
First year
Attend an approved staff training program within a specified period
Subsequent year(s)
Continue full-time employment in a designated office/unit
Maintain registration annually
Complete required courses
Pass one or more sets of examination, or receive exemption from them
Pass Final Examination
Complete prescribed practical experience (if not complete)
File prescribed practical experience certification form and apply for membership
RECEIVE PROFESSIONAL DESIGNATION

33. The International Federation of Accountants has developed a series of International Guidelines on Education. In the introduction to its guideline on pre-qualification education and training, IFAC notes that society has a right to expect that an accountant who accepts a professional engagement or occupation is professionally competent, that is, that he has the required sum of knowledge, that he can apply the knowledge to practical problems and that he has a professional approach to his work. It also notes that this places upon the accountancy profession two important obligations. The first is to ensure that the range and depth of knowledge and skills command the respect and meet the needs of those who will rely on the professional work of its members. The second is to do all in its power to ensure that its members maintain the quality of service and knowledge that the public is entitled to.

34. One of the eight guidelines issued to date covers the core of knowledge - professional subjects. The following subjects are discussed: financial and management accounting; information systems and EDP; auditing; taxation; and

business finance. The guideline notes that, while the imparting of knowledge is accomplished in various ways, each subject should not be considered solely as a separate study. The professional practice of accounting requires the application of knowledge drawn from many subjects, thus, the emphasis in educating and examining the students should be on the relationships of each topic to the others. They should also be studied against the background of relevant support subjects such as behavioural sciences, economics, law, mathematics and statistics, and functional business subjects, for example, management. 4/

35. Other guidelines include the test of professional competence, practical experience, the core of knowledge - supportive subjects, and the impact of information technology on the education of the accountant.

H. Post-qualification education

36. Education and training does not end when the student becomes a full member of a professional organization. The professional accountant's knowledge and skills have to be kept up to date. Consequently, many professional accountancy organizations have established committees and programmes to look after the ongoing needs of its members in these areas.

37. IFAC has also published a guideline on continuing professional education. While acknowledging that professional competence consists of more than merely maintaining and updating technical knowledge in that it indicates factors such as judgement, attitude and the ability to apply appropriate principles to practical situations, it does note that the member who is not up to date with current technical knowledge (in that member's area of expertise) cannot provide a competent service. A programme of continuing professional education, therefore, is a vital element in preserving the standards of the profession and maintaining public confidence. 5/

38. IFAC notes that the basic objectives of any programme of continuing professional education are as follows:

(a) To maintain an adequate level of technical knowledge among its members;

(b) To assist members of the profession in adapting to the evolution of new techniques, changing responsibilities and economic conditions;

(c) To demonstrate to society at large the concern of the profession for the public interest by encouraging members of the profession to have adequate technical knowledge and skills to provide the services reasonably expected of them.

39. There is still some debate about whether continuing professional education should be mandatory or optional. Although a number of organizations have imposed some form of mandatory requirement, a voluntary approach is more common. Some organizations have adopted a monitored voluntary approach. For example, the Institute of Chartered Accountants in England and Wales recommends that its members keep a record of their continuing professional education. 6/

I. Code of conduct

40. IFAC has noted that four basic needs have to be met if the accounting profession is to meet the highest standards of professionalism, attain the highest levels of performance and meet its responsibility to the public. They include credibility, professionalism, quality of services and confidence. The fundamental principles are integrity, objectivity, professional competence and due care, confidentiality, professional behaviour, and carrying out services in accordance with the relevant technical and professional standards. 7/

41. Since it is in the interest of their members that these four basic needs be met and maintained, several organizations have established a code of conduct for their members. The types of issues covered in such a code include the following:

(a) Personal integrity. A member who is convicted of any criminal or similar offence will usually face expulsion;

(b) Professional conduct;

(c) Confidentiality regarding the affairs of any client;

(d) Professional excellence and good taste;

(e) Courtesy and consideration in any dealings with professional colleagues;

(f) Standards of conduct affecting the public interest.

42. Establishing procedures by which errant members can be disciplined is normally an important function of any professional accountancy organization. The task of preparing detailed ethical requirements is the responsibility of the organization concerned and will vary from country to country. In some instances, this responsibility is assumed by the legislative body of the country concerned, but it is commonly included in the constitution of the professional accountancy organization itself.

43. The typical functions of a disciplinary committee are as follows:

(a) On receipt of a complaint, consider whether any action should be taken;

(b) Investigate the complaint;

(c) Determine if there has been misconduct or if the rules of the organization have not been complied with;

(d) Conduct a hearing;

(e) Impose sanctions where necessary, for example:

(i) Require education and training courses to be undertaken;

(ii) Reprimand member;

(iii) Impose fine on member;

(iv) Suspend member;

(v) Expel member.

A procedure for appeals is also normally provided.

J. Other responsibilities

44. Other powers and responsibilities of a professional accounting organization are described in the following paragraphs.

1. Financial

45. Most professional accountancy organizations are self-supporting and therefore have to levy fees on their members. The fee structure varies, depending on the size and objectives of the organization. Generally, there is a basic fee, which is payable by all members (although it may be discounted for certain categories of membership, for example, members retired from active employment, non-resident members). Additional fees may be assessed on certain members, such as those in the practice of public accounting, especially where a primary objective of the organization is to service the needs of such members. Fees from members will often be supplemented by income from investments and from other sources (for example, grants and donations).

46. It is also the responsibility of a professional accountancy organization to finance the various programmes that are undertaken (for example, courses and examinations for those applying for membership, professional development courses). This is frequently accomplished, at least in part, by fees assessed on those who benefit from such programmes.

2. Communication with members

47. It is important for any professional organization to maintain contact with its members, and professional accountancy organizations are no exception. There are several means of communication, including the following:

(a) Annual and special meetings (agendas of such meetings frequently include voting on resolutions proposed by the organization's governing council);

(b) Newsletters;

(c) Professional journals (magazines), which include items and articles of both general interest to all members and specific interest to various categories of members;

(d) Annual reports and financial statements;

(e) Publication of studies, reports and other documents of interest to its members.

3. Responses to inquiries on technical and other issues

48. Many organizations provide a service of responding to inquiries on technical and ethical issues from their members. The degree of sophistication with which these inquiries can be handled depends on the objectives, size and available resources of the organization. In some cases, this type of service is extended to the general public. Generally, the service is provided free of charge, although some organizations charge a fee for certain types of inquiries. The Technical Hotline Service of the American Institute of Certified Public Accountants (AICPA) is one of the more formalized examples of this type of service. Members can call a toll-free telephone number and be provided with an informal response to questions on accounting and auditing issues. Several hundred inquiries per month are dealt with through this service. The views expressed by the Institute's Technical Information Service are intended solely to assist its members in resolving accounting and reporting questions, and it is clearly stated that the answers are based only on the facts presented; they should not be used for any other purpose and are not official opinions of AICPA or any of its committees, unless so indicated. The answers provided have to be accepted as the personal views of the individuals who offer them; every effort is made, however, to reply in a reliable and helpful way to the inquiries presented.

4. Government relations

49. As noted in section C above, communications with Government on national policies, legislation and other matters of concern to both its members and society in general, is often one of the responsibilities of a professional accountancy organization. Since it is often impossible to reflect the views of all members on such issues, specific groups will usually be set up to undertake these activities on the organization's behalf. The views are often represented as those of the group concerned, although every effort is normally made to ensure that such views are reflective of at least a significant portion of the members.

5. Relations with other professional organizations

50. Liaison with other professional organizations, both on issues that have the potential to result in conflicts of interest between members of the two or more organizations and on issues of common interest, is often another common responsibility of professional accountancy organizations. Such liaison may take place:

(a) Between professional accountancy organizations within the same country;

(b) Between professional accountancy organizations in different countries;

(c) Between professional accountancy organizations and other professional organizations (for example, the legal and actuarial professions) in a particular country.

51. Organizations such as the Féderation des experts comptables européens and the International Federation of Accountants have been set up, in part, to facilitate relationships between professional accountancy organizations in different countries. With respect to item (c) above, it is not uncommon for joint committees to be set up to reflect the views of members in different disciplines in areas of common interest.

6. Auditing, accounting and financial reporting standards

52. For those professional accountancy organizations in which the predominant, or a significant, proportion of the membership is involved in the practice of public accounting (which includes auditing), the setting of auditing standards (and other standards relevant to public accounting) is normally an important activity.

53. Practice varies from country to country in respect of the responsibility for setting accounting and financial reporting standards. Although the ultimate responsibility for such standards is that of the Government of the country concerned, this responsibility has often been delegated, in various degrees, however, to private sector organizations. Even where accounting and financial reporting standards remain the primary responsibility of Government, it is often an important function of a professional accountancy organization to comment on draft standards and provide input to the standard-setting process.

54. Professional accountancy organizations in several countries are also actively involved in the development of the standards of the International Standards Committee. Some countries either adopt such standards as their own or use them as the basis for developing their own standards. (This is not necessarily restricted to those countries directly involved in the development of such standards.)

K. Conclusion

55. Some of the main features of the organization of the accounting profession and the structure and responsibility of professional accountancy organizations have been set out above. There would be no value in developing standard objectives or a standard structure or in setting out a standard list of responsibilities, since such depend to a large extent on local circumstances and needs.

II. QUALIFICATION OF AUDITORS

A. Introduction

56. An audit has been defined as:

> "An examination of evidential matter to determine the reliability of a record or assertion or to evaluate compliance with rules or policies or with conditions of an agreement. In connection with financial statements or other financial information, [an audit is] an examination of accounting records and other supporting evidence for the purpose of expressing an opinion as to whether such statements or information are presented fairly in accordance with an appropriate, disclosed basis of accounting." 8/

57. An auditor has been defined as "a person who conducts an audit". 9/

58. There are different types of audits, for example, financial statement audits, income tax audits, "value for money" audits and environmental audits. This section is concerned with the qualification of auditors in respect of financial statement audits, the area in which, over the years, the accounting profession has built up a significant amount of expertise.

59. A financial statement audit generally culminates in an opinion by the auditor about whether the financial statements present a "true and fair view" of the financial position and results of operations of an entity (or are in accordance with a recognize set of generally accepted accounting principles), an opinion about whether they have been prepared in accordance with a set of legal requirements, or a combination of both types of opinion. In several continental European countries, the primary emphasis has historically been on compliance with legal requirements, whereas in North America, it has been on conformity with "generally accepted accounting principles" ("true and fair view"). In the United Kingdom, the emphasis has been on both aspects; with the requirement to follow the Fourth and Seventh Directives of the Council of the European Communities, this is likely to be the emphasis in all countries in the European Community in the future.

60. In May 1987, the OECD Working Group on Accounting Standards organized a round-table discussion on this subject. In its contribution to that discussion, representatives from the Business and Industry Advisory Committee (BIAC) noted that:

> "... users of accounts need not rely solely on the skills and integrity of the preparers but can additionally rely on the assurance provided by the auditor that the accounts are ... 'true and fair'."

It further noted that:

> "... to be effective in providing this assurance, [the audit] needs to be undertaken by a professional expert who is both independent of management and whose integrity in performing the audit can be relied on. The three essential elements of competence, independence and objectivity are distinct but are closely related." 10/

61. The first three questions to which those attending the round-table discussion were asked to respond were based on these three essential elements. As has already been noted, the qualities of competence and objectivity are prerequisites for any professional accountant. Independent is an additional required quality of an auditor, owing to the nature of the activity in which auditors are engaged.

B. Required qualities of an auditor

1. Competence

62. The summary note to the OECD round-table discussion stated that "most countries require a combination of education and practical knowledge, as well as the successful completion of an examination testing those skills", 11/ before an individual can be certified to act as an auditor.

(a) Education

63. Educational requirements have already been covered in general terms in section I.G, above. It was noted that a university degree is now a requirement in many countries before an individual is even qualified to become a student. During the apprenticeship period, the education process continues. It was also noted that a core of knowledge is required before one is qualified to become a professional accountant. This is particularly the case with respect to the auditing profession.

64. Knowledge of auditing theory and practice is an essential element for those choosing to enter the auditing side of the accounting profession. In the auditing section of its guideline on the core of knowledge, IFAC notes that the key issues that must be elaborated upon are auditing objectives, auditing concepts, evidence, practices and procedures, and the rights, duties and liabilities of auditors. In addition, an audit cannot be undertaken in isolation of an in-depth knowledge of pertinent issues in related areas, such as accounting, business and finance, and information systems.

65. The Eighth Directive of the Council of the European Communities also attaches a significant degree of importance to education. In article 5, the Directive notes that a required examination of professional competence must guarantee the necessary level of theoretical knowledge for the statutory auditing of documents referred to in the Directive, and the ability to apply such knowledge in practice. Article 6 states that the text of theoretical knowledge included in the examination must cover, in particular, the following subjects:

(a) Auditing;

(b) Analysis and critical assessment of annual accounts;

(c) General accounting;

(d) Consolidated accounts;

(e) Cost and management accounting;

(f) Internal audit;

(g) Standards relating to the preparation of annual accounts and consolidated accounts and to methods of valuing balance-sheet items and of computing profits and losses;

(h) Legal and professional standards relating to the statutory auditing of accounting documents and to those carrying out such audits;

in so far as they are relevant to auditing:

(i) Company law;

(j) The law of insolvency and similar procedures;

(k) Tax law;

(l) Civil and commercial law;

(m) Social-security law and law of employment;

(n) Information and computer systems;

(o) Business, general and financial economics;

(p) Mathematics and statistics;

(q) Basic principles of the financial management of undertakings.

66. It should come as no surprise that educational requirements, as set out in section I.G above, are no less stringent for auditors than they are for any other class of professional accountant.

(b) Practical experience

67. As also noted above, some professional accountancy organizations require that a programme of practical training be completed before an individual can receive a designation as a professional accountant, since this will enable students to apply their academic background and technical skills to the type of problems they are likely to encounter. This practical training is frequently undertaken with a firm of public accountants (auditors), irrespective of whether the student's intended field is auditing or some other branch of the accounting profession.

68. Whereas a practical training programme is highly desirable for other branches of the accounting profession, it is an essential requirement if an individual is to be qualified to act as an auditor. Such experience must be in the field of auditing; it cannot be undertaken in Government or industry. In addition, the practical experience must be relatively recent. It is not acceptable for an individual who has not been involved in auditing for an extensive period to be licensed to undertake an audit.

69. Practical experience is required in most, if not all, countries, especially in respect of audits of public companies over a certain size.

70. Article 4 of the Eighth Directive of the Council of the European Communities provides that a person "may be approved to carry out statutory audits [of accounts] only after having attained university entrance level, then completed a course of theoretical instruction, undergone practical training and passed an examination of professional competence of university final examination level organized or recognized by the State [concerned]". With respect to practical training, article 8 notes that this must be acquired by a minimum of three years' practical training on the audits of annual accounts, consolidated accounts or similar financial statements. At least two thirds of such practical training must be completed under an approved person.

2. Independence and objectivity

(a) Independence

71. In its OECD round-table response, BIAC noted that "the independence of the auditor from management influence is necessary for him to be able to report ... on the accounts prepared by management". 12/ In a number of countries, this matter is regarded to be of such significance that it is enforced by law. For example, the Canada Business Corporations Act, section 155, states that "a person is disqualified from being an auditor of a corporation if he is not independent of such corporation or its affiliates". The principle of the independence of auditors is expressly laid down by article 24 of the Eighth Directive of the Council of the European Communities; it is left up to member States, however, to determine the conditions of this independence and the appropriate sanctions. In Japan, the independence requirement is laid down by the Securities and Exchange Law.

72. Auditing standards also stipulate the requirement for independence. In its guideline on basic principles governing an audit, the International Auditing Practices Committee of IFAC notes that the auditor "should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity". 13/ Examples of an auditor not deemed to be independent of the audit client include the following:

(a) The auditor, the auditor's spouse or any immediate family member is a director or officer of the client;

(b) Any partner of the auditor is a director or officer of the client;

(c) There is financial involvement with a client, by holding a direct financial interest or indirect material financial interest in the client's affairs (for example, by being a trustee of a trust that has a financial interest in a client company), by loans to or from the client, or any officer, director or principal shareholder of a client company, or by holding a financial interest in a joint venture with a client or employee(s) of a client.

73. Acceptance of goods or services from a client may also constitute a threat to independence.

(b) Objectivity

74. Objectivity is closely linked to independence and, in fact, is often used as a synonym for that term owing to the fact that, if not objective, the auditor cannot be independent (and vice versa).

(i) Provision of other than audit services to a client

75. It is often maintained that objectivity cannot be achieved if the auditor or the auditor's firm:

(a) Prepares the financial statements that are subject to audit, or the underlying records from which the audited financial statements are prepared;

(b) Renders non-audit services to audit clients.

76. The question of objectivity will often depend on the circumstances. It is generally recognized that the auditor's objectivity may be questioned if that person individually participates in related or unrelated activities on behalf of the client.

77. It is not so clear, however, whether objectivity is threatened when other individuals in the auditor's firm are engaged in such activities, particularly if there are safeguards within the firm to ensure that such objectivity is not threatened.

(ii) Audit fees

78. It has also been questioned whether there can be objectivity if a significant portion of the auditor's total fee income comes from a single client, or from a very limited number of clients. This is a highly contentious area in which views differ.

(iii) Auditor rotation

79. The BIAC contribution to the OECD round-table discussion also noted that a further threat to objectivity (independence) "may occur where an auditor becomes too closely identified with the areas and interests of the management". It notes that "this is often a difficult situation to identify and to deal with and its avoidance requires vigilance on the part of the auditor and the client". 14/ It has been suggested that placing a time limit on the tenure of the audit firm would assist in preventing this situation from occurring. BIAC went on to state, however, that "while such a solution may appear superficially attractive, it is generally recognized that a considerable cost would be involved in introducing a new audit firm every, say, five years due to the need for it to become familiar with the company's business, procedures and policies. It is considered that any advantage from such rotation would be seriously outweighed by the cost ... Different considerations, however, may apply to changing the individual partner on

the audit". 15/ It is interesting to note that representatives from the Trade Union Advisory Council of OECD were of the view that a time limit (say, six years) for an auditor's or audit firm's term of office should be implemented and that the appointment of another auditor or audit firm after this time should be required. 16/

80. It has generally been left up to professional organizations to monitor the question of objectivity. It is rarely dealt with by legislative bodies. For example, the Directives of the Council of the European Communities do not provide any specific restrictions on the auditor's rendering of non-audit services, neither does it require publication of fees for audit or non-audit services.

(c) Integrity

81. There is the general requirement that auditors have to be persons of good repute. The guideline on basic principles governing an audit, issued by the International Auditing Practices Committee of IFAC, notes quite simply that "the auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity". 17/

C. Overseeing of auditors

1. Licensing

82. In many countries, statutory bodies have been set up to issue licences to auditors. For example, in Australia, all auditors must be registered with the National Companies and Securities Commission. In France, auditors must be registered by the District Audit Commission attached to the Appeal Court competent for their place of residence or their registered office. In Sweden, authorization and registrations of certified auditors are made by the Board of Commerce, which is a governmental authority serving under the Justice Department.

83. In many other countries, membership of a specified professional accountancy organization is required before an individual can act as an auditor. In some cases, a licensing body will accept membership of a specified professional accountancy organization as a prerequisite for registration; in a number of countries, such membership is required.

84. The primary function of licensing auditors is to ensure that the educational and practical experience requirements have been met. They are set up for the public protection, to ensure that only those who are competent to act as auditors do in fact do so.

2. Practice inspection

85. In some countries, professional accountancy organizations have set up a system of practice inspection to ensure that those involved in the practice of public accounting (auditing) maintain an appropriate level of professional standards. This is now standard practice in Canada, where all the provincial institutes of

chartered accountants have set up such systems; their primary intent is educational, that is, to help practitioners improve their professional standards, where necessary. A serious failure to maintain professional standards, however, could lead to disciplinary action being taken against the member concerned.

86. In addition, most of the larger auditing firms have their own inter-office inspection programmes.

3. Codes of conduct and disciplinary proceedings

87. As noted in section I.I above, disciplinary committees have been set up by professional accountancy organizations in many countries to ensure adherence to the high standards of the profession and to maintain public confidence.

D. Auditing standards

88. A comprehensive body of generally accepted auditing standards has now been developed and established in many countries. These have been established primarily by the auditing profession.

89. Generally Accepted Auditing Standards have been summarized as follows:

1. General standards

The examination should be performed and the report prepared by a person or persons having adequate technical training and proficiency in auditing, with due care and with an objective state of mind.

2. Examination standards

(a) The work should be adequately planned and properly executed. If assistants are employed, they should be properly supervised.

(b) There should be an appropriately organized study and evaluation of those internal controls on which the auditor subsequently relies in determining the nature, extent and timing of auditing procedures.

(c) Sufficient appropriate audit evidence should be obtained, by such means as inspection, observation, inquiry, confirmation, computation and analysis, to afford a reasonable basis to support the content of the report.

3. Reporting standards

(a) The report should identify the financial statements and distinguish between the responsibilities of management and the responsibilities of the auditor.

(b) The report should describe the scope of the auditor's examination.

(c) The report should contain either an expression of opinion on the financial statements or an assertion that an opinion cannot be expressed. In the latter case, the reasons therefor should be stated. 18/

90. IAPC has issued a series of International Auditing Guidelines in the belief that they will help to improve the degree of uniformity of auditing practices and related services throughout the world. 19/

E. Conclusion

91. In its concluding note to the OECD round-table discussion, BIAC noted that "regulatory authorities are correct in being concerned to ensure that the competence, independence and integrity of auditors are safeguarded. Care needs to be exercised, however, in establishing mechanisms to achieve this, particularly where threats to independence are more apparent than real and where the costs of the proposed solutions far outweigh such benefits as might accrue". 20/

92. A competent auditing profession is an essential feature in any country with a market-based economy, and it is in the interests of all sectors of society to ensure that the integrity of the auditing profession is maintained.

Notes

1/ The Shorter Oxford English Dictionary, 3rd ed. (Oxford, Oxford University Press, 1973).

2/ Kohler's Dictionary for Accountants, 6th ed. (Englewood Cliffs, New Jersey, Prentice-Hall, 1983), p. 7. Reference should be made to page 8 of the publication for a description of the term "accounting".

3/ Adapted from An Act Governing the Canadian Institute of Chartered Accountants, 2nd ed., VII, c.58 (1902), as amended.

4/ International Guideline on Education, No. 4, The Core of Knowledge - Professional Subjects (New York, International Federation of Accountants, August 1984), para. 36.

5/ International Guideline on Education, No. 2, Continuing Professional Education (New York, International Federation of Accountants, February 1982), para. 5.

6/ "First Schedule: public practice - notes for guidance. Part 1. Practicing certificates", Members Handbook, vol. 1 (London, Institute of Chartered Accountants in England and Wales), para. 20.

7/ International Guideline on Ethics for Professional Accountants (New York, International Federation of Accountants, July 1990), paras. 14-16.

Notes (continued)

8/ Terminology for Accountants, 3rd ed. (Toronto, Canadian Institute of Chartered Accountants, 1983), p. 13.

9/ Ibid., p. 15.

10/ Working Document by the OECD Working Group on Accounting Standards, No. 5. The Qualification of Auditors (Paris, Organisation for Economic Co-operation and Development, March 1988), p. 87.

11/ Ibid., p. 6.

12/ Ibid., p. 88.

13/ International Auditing Guideline No. 3 (New York, International Federation of Accountants, September 1980), para. 5.

14/ Working Document by the OECD Working Group on Accounting Standards, No. 5 ..., p. 88.

15/ Ibid., p. 89.

16/ Ibid., p. 91.

17/ International Auditing Guideline No. 3, ..., para. 5.

18/ CICA Handbook, sect. 5100, Generally Accepted Auditing Standards (Toronto, Canadian Institute of Chartered Accountants), para. 02.

19/ Preface to International Auditing Guidelines and Statements on Auditing (New York, International Federation of Accountants, February 1987, revised July 1989).

20/ Working Document by the OECD Working Group on Accounting Standards, No. 5 ..., p. 89.